NASCUS
National Association of State Credit Union Supervisors

January 24, 2011

Mary Rupp
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: NASCUS Comments on Notice of Proposed Rulemaking for Part 704 Corporate Credit Unions

Dear Ms. Rupp:

The National Association of State Credit Union Supervisors (NASCUS)[1] appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) concerning NCUA's proposed changes to the Corporate Credit Union Rule, Part 704, with corresponding changes to Parts 701 and 741. As the representative of state regulators, NASCUS understands and appreciates the issues NCUA attempts to address by this rulemaking. State regulators share NCUA's concerns that the material risk presented by the corporate system needs to be mitigated. We also share NCUA's commitment to sound regulatory oversight of the credit union system. However, some of the proposed rule's provisions impermissibly encroach into areas properly regulated by the states. Other proposed revisions raise additional concerns as discussed below.

1) Proposed §701.5 & §741.226 Membership limited to one corporate credit union

NCUA "seeks to prevent unhealthy competition among corporates by requiring [federally insured credit unions] to make a decision to commit to membership in one corporate at a time." <u>See 75 Federal Register 228 (November 29, 2010) p. 73001.</u>

<u>Issue properly left to state law</u>

Proposed §701.5 and §741.226 do not directly regulate corporate credit unions, but rather place regulatory restrictions on federally insured natural person credit unions. While NCUA may have greater authority over corporate credit unions under § 704, its authority over federally insured state-chartered natural person credit unions is historically more limited. Specifically, state law has long controlled state-chartered credit union investments. Currently NCUA rules expressly recognize that these state specific investment authorities ("non-conforming investments") are

[1] NASCUS is the professional association of the 46 state credit union regulatory agencies that charter and supervise the nation's 3,000 state-chartered credit unions.

permissible.[2] NCUA's stated rational for preempting this traditional state authority is to prevent unhealthy competition among corporates. This rationale is flawed.

NCUA states that "rate shopping" led corporates to engage in unsafe investments in order to generate higher yields to compete for members. NASCUS notes that while ***some*** corporates may have engaged in unsafe and unsound investment practices, not all corporates did. NCUA engaged an independent entity to determine the causes of the corporate failure and evaluate NCUA's comprehensive re-regulation of the corporate system. If the entity found that "rate shopping" was a primary contributor to the failures, NCUA should discuss what recommendations the independent entity made to mitigate "rate shopping."

Finally, NASCUS notes that the proposal would not eliminate "rate shopping." Natural person credit unions would still have the ability to move between corporates, albeit more slowly, if one corporate sought to move aggressively to offer higher yields. Furthermore, because the restriction is **not** placed on the corporates themselves, but rather on natural person members, corporates could still engage in unhealthy competition for the non-federally insured credit union patronage. For instance, banks, cooperatives, credit union leagues, and credit union service organizations (CUSOs), are free to join as many corporates as they desire. In fact, given the limitations on natural person credit unions, the "value" of these other entities as members may increase, consequently driving the same rate shopping dynamic NCUA purports to restrain.

<u>Encourages unsafe concentration and restricts credit union choice</u>

In addition to infringing on state authority, the proposal to limit natural person credit union membership to a single corporate would actually encourage concentration of the natural person credit union's exposure to the corporate. It would also limit the ability of many natural person credit unions to make business decisions to address changing needs. In some cases, different corporate credit unions may provide different services that are a match for a given natural person credit union. However, under NCUA's proposal, a natural person credit union would have to select a single corporate for all such services (unless it seeks services outside of the credit union system). Not only would this unnecessarily constrain credit unions' ability to seek the best fit for each particular service, it would also leave natural person credit unions overly reliant on a single vendor for multiple services. This is contrary to NCUA's and state regulators' recent emphasis on sound third party due diligence and diversification.

Finally, the proposal limiting membership to a single corporate raises more questions than it answers. Under the proposal, existing corporate memberships would be grandfathered, but it is unclear how existing corporate memberships would be handled in the future. <u>See 75 Federal Register 228 (November 29, 2010) p. 73001.</u> What does the proposal mean for credit unions with existing corporate memberships should those credit unions seek to join another corporate in the future? For example, will a credit union with grandfathered corporate memberships be prohibited from joining another corporate once they evaluate the forthcoming corporate credit union business plans? If they are allowed to join an additional corporate, may they maintain ***all*** of their existing memberships, or must they withdraw from one existing corporate or from all of them? What about the case of a merger between credit unions with different corporate credit

[2] See Part 741.3.

union memberships? Would both memberships be grandfathered in, or would the surviving credit union have to choose its membership? On all of these questions, the proposed rule is silent.

Finally, NCUA asserts that the grandfather provision results from the agency's belief "that the members of a credit union are owners of that credit union, including the members of a corporate, and that "once a member, always a member." Id. P. 73001. This position cannot be reconciled with the proposal, which contemplates that future members (and presumably owners in NCUA's view) will not always be member/owners.

Given the infringement on state authority, the uncertain benefits of proposed §701.5 and §741.226 (as outlined above) and the uncertainty of practical implementation, these proposals should not apply to state-chartered credit unions in a final rule.

2) Proposed §704.11 & §704.19 disclosure of compensation

NCUA proposes to amend the newly enacted corporate credit union rules to require disclosure of compensation received by certain employees of the corporate credit union from a corporate CUSO. The new corporate rule already requires disclosure of compensation paid by the corporate to certain employees. See 75 Federal Register 228 (November 29, 2010) p. 73010.

The corporate veil

State regulators support transparency and share NCUA's concerns that no decisions from corporate credit union leadership be driven by conflicts of interest. With respect to transparency, state-chartered credit unions must disclose the compensation of certain employees pursuant to existing Internal Revenue Service (IRS) Form 990 (IRS 990) filing requirements. NASCUS appreciates that a corporate CUSO may not be subject to IRS 990 requirements or that even if the corporate CUSO is subject to IRS 990 filing requirements, the corporate employees may not meet the IRS's disclosure thresholds. However, the proposed rule does raise a concern for state regulators.

Current state and federal rules generally require corporate separateness between CUSOs and their credit union owners. NCUA's combined corporate and CUSO compensation disclosure requirement, with the disclosure being made by the corporate, could serve as evidence to pierce the corporate veil and inadvertently expose the corporate to the liabilities of its CUSO.

At a minimum, NCUA should ensure that this proposal does not inadvertently weaken the corporate separateness between a CUSO and a corporate credit union.

3) Proposed §704.13(c)(8) board responsibilities

The proposal would add a new section, (c)(8), to the new final rule's board responsibility requirements of §704.13. The proposed addition would require all board of directors' votes to be recorded votes, including identifying board members by name who voted for or against a particular item, as well as the board members who were absent or abstained. NCUA states the proposal is "necessary to increase transparency." See 75 Federal Register 228 (November 29, 2010) p. 73011.

Specific governance provisions such as conduct of a board vote for state-chartered corporate credit unions currently are, and should be, a matter of state law

Specific governance provisions, such as voting requirements for boards for state-chartered credit unions, including corporate credit unions, are a matter of state law. There is no compelling reason why precedent deferring to state law should be ignored.

NCUA's authority for the proposed voting requirements, cited as 12 U.S.C. 1761, 1766, 1781, 1789 and 1782 (NCUA authority to require submission of financial data, records, and other information and to require the making of reports), is unpersuasive. There is no doubt that NCUA can require the collation, tabulation and submission of a plethora of financial and performance data. Likewise, NASCUS does not dispute NCUA's authority to require submission of board minutes and other general information. However, the proposal goes beyond requesting financial information and intrudes into board operations by dictating ***how*** board votes are recorded. This is beyond the statutory authority cited by NCUA.

Furthermore, NCUA's focus on individual board members is just as likely to weaken the discipline of joint and severable board liability as it is to enhance board diligence. Focusing on individual votes could weaken corporate governance by leading directors to believe they will be indemnified from consequences of a board action they opposed, but was carried out by their board. NASCUS believes the board is strengthened when all board members understand they are responsible for the actions of the board regardless of their individual vote.

4) **Proposed §704.15 auditing and reporting requirements**

The proposed rule contains numerous new or amended requirements related to auditing and reporting, including requirements that audited financial statements be prepared according to Generally Accepted Accounting Principles (GAAP); that management prepare an annual report enumerating its compliance with various laws and regulations; and that the corporate credit union's independent audit meet certain requirements. See 75 Federal Register 228 (November 29, 2010) p. 73011.

Overly detailed regulation

Taken individually, several of the proposed requirements are understandable from a regulatory perspective. However, taken as a whole, the overall proposal reflects a regulatory redundancy and overly detailed effort to cover every possible contingency by regulation.

For example, NCUA specifically seeks comment on whether management should certify a report annually documenting the corporate credit union's compliance with various enumerated regulations.[3] Such a report is unnecessary and may imply non-enumerated regulations are less important. State regulators hold credit union management responsible for compliance with all

[3] See proposed §704.15(a)(2)

applicable laws and regulations, as well as for the safe and sound operation of the institution. The Board is ultimately responsible for overseeing the management and providing direction for the institution. If state regulators detect a pervasive lack of competence or compliance, the regulators can take action such as removing directors and management.

5) Proposed §704.21 equitable distribution of stabilization costs

NCUA proposes to have each corporate credit union submit a list of its members that are not "federally insured credit union" entities, including banks, cooperatives, leagues, CUSOs, associations and non-federally insured credit unions. NCUA would then, when billing federally insured credit unions for the annual corporate stabilization fund repayment, use a formula to generate the equivalent assessment for those corporate members and bill them for a "voluntary" payment. If the entity refused to pay the full assessment, NCUA would require the corporate credit union to hold a membership vote within 90 days to determine whether that member should be expelled. NCUA characterizes this as those entities paying their "fair share." See 75 Federal Register 228 (November 29, 2010) p. 73013.

The membership of a state-chartered corporate credit union is a matter of state law and regulation

For state-chartered corporate credit unions, state law controls field of membership and membership eligibility. NCUA has no authority to dictate membership requirements to a state-chartered credit union. Even under NCUA's arguably broader corporate authority, there is no meaningful nexus to safety and soundness as a basis for NCUA's assertion of this authority.

Whether an entity chooses to contribute to the repayment of the stabilization fund has no bearing on the safety and soundness of its corporate. Lacking the safety and soundness nexus, NCUA should decline to extend this proposal to state-chartered corporate credit unions.

NCUA cites as its authority to promulgate this proposed regulation 12 U.S.C. 1772a and 1789.[4] Neither of these provisions provides a compelling basis for this authority. The Federal Credit Union Act (FCUA) §1772a establishes the authority of the NCUA to accept unconditional gifts "by will or otherwise" for carrying out the purposes of the FCUA. Mandating a payment to NCUA by an entity beyond its statutory jurisdiction under threat of adverse action is not within the spirit or intent §1772a. Nor does §1789 grant NCUA the extraordinary power to demand assessments from entities beyond its statutory authority. Neither §1789(a)(7) nor §1789(a)(11)

[4] **12 U.S.C. 1772a Gifts; acceptance of conditional gifts; deposit**.—The Board is authorized to accept gifts of money made unconditionally by will or otherwise for the carrying out of any of the functions under this chapter. A conditional gift of money made by will or otherwise for such purposes may be accepted and used in accordance with its conditions, but no such gift shall be accepted which is conditioned upon any expenditure not to be met there from or from income thereof unless the Board determines that supplementation of such gift from the fees it may expend pursuant to sections 1755 and 1756 of this title or from any funds appropriated pursuant to section 1766(f)(2)(C) of this title for the purpose of making such expenditure will not adversely affect the sound administration of this chapter. Any such gift shall be deposited in the Treasury of the United States for the account of the Administration and may be expended in accordance with section 1755 or as provided in the preceding sentence.

was intended to grant such authority.[5] These two provisions provide NCUA incidental powers and the authority to promulgate regulations. If these entities are beyond NCUA's statutory authority, then certainly they are beyond NCUA's regulatory authority and such power would be more than "incidental."

Without express statutory authority, and with no safety and soundness nexus, proposed §704.21 cannot be extended to dictate state-chartered corporate credit union membership.[6]

NASCUS also believes the proposed "voluntary" payments under threat of expulsion, is ultimately counterproductive. In September, 2010, NCUA promulgated comprehensive new rules for the corporate credit union system. State regulators concurred with the new capital requirements for corporates. Given that corporate credit unions must retain more capital as a reserve, it seems counterproductive to be forcing out of the corporate system potential sources of capital or income that build retained earnings.

6) Proposed §704.22 enterprise risk management

NCUA's proposal requires corporates to "develop and follow an enterprise risk management policy." This section mandates the establishment of an enterprise risk management committee that is responsible for overseeing the corporate's risk management practices and for reporting at least annually to the Board. The committee must include at least one independent risk management expert with experience in identifying, assessing and managing risk exposures. See 75 Federal Register 228 (November 29, 2010) p. 73013.

Redundant risk oversight

NASCUS supports robust risk management practices and procedures at corporate credit unions and at all credit unions. We do, however, see the establishment of an enterprise risk committee as redundant, a potentially significant drain on the corporate's resources, and unnecessary.

Managing risk is a fundamental responsibility of the Board of Directors of a corporate credit union. Corporates are required to have an Asset-Liability Committee (ALCO) that reviews asset and liability management reports and that reports to the board on at least a monthly basis. These reports must address compliance with the FCUA, NCUA Rules and state regulations. In addition to the ALCO, corporate credit unions have other committees, such as the supervisory and audit committees that report to the board on risk management and other issues. Corporate credit unions are also subject to state and federal regulatory examinations, internal audits, and external audits. Lastly, the new NCUA Rules and Regulations §704 greatly reduces the amount of risk that can be taken by corporates as well as increases the required risk modeling and other

[5] 12 U.S.C. 1789(a)(7) and §1789(a)(11) read, respectively:
(a)(7) exercise all powers specifically granted by the provisions of this title and such incidental powers as shall be necessary to carry out the powers so granted; ….
(a)(11) prescribe such rules and regulations as it may deem necessary or appropriate to carry out the provisions of this title.

[6] NASCUS doubts the authority of NCUA to promulgate this requirement for federal corporate credit unions, but limits our comments to state charters specifically.

reporting. With all of the current oversight in place, a requirement for another committee that would duplicate the current oversight is unnecessary.

NASCUS appreciates the opportunity to comment on NCUA's proposed revisions to §704, Corporate Credit Unions. NASCUS and state regulators remain committed to working in partnership with NCUA to ensure the safety and soundness of the credit union system. As noted at the beginning of this letter, state regulators share many of NCUA's concerns. However, in general, state regulators believe those concerns may be better addressed through existing regulation and supervisory oversight.

Please do not hesitate to contact me to discuss our comments further.

Sincerely,

- signature redacted for electronic publication -

Brian Knight
Senior Vice President & General Counsel